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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949.

No.....

NELLIE IONE GRAY, EVLYN LEVISON, A. C. McLAUGHLIN, and the PHILLIPS PETROLEUM COMPANY, PETITIONERS,

vs.

AMBROSE OLDLAND, et al, RESPONDENTS.

BRIEF OF RECTOR GROUP OF RESPONDENTS UPON PETITION FOR WRIT OF CERTIORARI

STATEMENT OF THE CASE

This brief in response to a Petition for Writ of Certiorari is filed on behalf of what is known as the "RECTOR GROUP" of Respondents, which group is composed of ROSA MYRTLE RECTOR, as Widow and Administratrix of the Estate of JAMES WILLIAM RECTOR, Deceased, JAMES RICHARD RECTOR, RUBY RECTOR KIRBY and LEONA RECTOR HINRICKS, son and daughters of the said JAMES WILLIAM RECTOR, Deceased and said ROSA MYRTLE RECTOR.

Due to the inadequacy and incorrectness of Petitioners'

Statement of the case, these Respondents set forth below a brief statement thereof based upon the undisputed evidence in the record.

JAMES WILLIAM RECTOR, now deceased, during his lifetime was one of the original ten pioneers in Rio Blanco County, Colorado, who on or about the year 1901 filed on the oil and gas land in controversy in this action under the OIL PLACER CLAIM ACT.

JAMES WILLIAM RECTOR died in Mesa County, Colorado, on the 20th day of December, 1942, and his estate was duly probated and the Respondents above named, under the proper statutory proceedings in the County Court of Mesa County, were decreed to be the heirs-at-law of JAMES WILLIAM RECTOR, Deceased.

ROSA MYRTLE RECTOR, as surviving widow, was decreed to be the owner of an undivided one-half interest of the aforesaid estate and the three surviving children above-named were decreed to be the owners of an undivided one-sixth interest each in and to the aforesaid estate. (R. 552)

The original group of the ten pioneer placer claimants including James W. Rector continued to hold possession under their oil placer claims, expended considerable money upon shallow drilling operations, and after the passage of the Federal Oil Leasing Act of 1920, applied for an oil prospecting permit on the land in question (R. 384-387). The permit was issued February 5th, 1924, and provided if production were obtained, a royalty of 20% be paid to the United States until the permittees should apply for a Federal lease (R. 389-392). The Statute in effect at that time provided that a "Permittee" might apply for and obtain a lease for a royalty to the United States of 5% on one-fourth of the permit acreage and a graduated royalty on the balance of the acreage.

On March 15th, 1926, the Oldland Group (ten original

pioneers), one of whom was Respondents' ancestor, JAMES WILLIAM RECTOR, executed an assignment of the permit to A. C. McLAUGHLIN, an experienced oil man (R. 13-19). By the terms of this instrument McLaughlin agreed to "fulfill the terms and conditions of said permit within the period therein prescribed, or any extensions thereof". He was granted the use of drilling equipment of the OLDLAND GROUP for this purpose. He was given the right to terminate his obligations under the assignment by reassignment to the OLDLAND GROUP and payment of $2,000.00 if he had not complied with the drilling requirements of the permit. In the event of discovery, he was obligated to apply for leases and to have the privilege of designating the one-fourth of the area upon which the Government royalty should be 5%. The agreement then provides:

> "That in the event of leases being issued to Assignee embracing respectively one-quarter and three-quarters of said permit area, Assignee shall pay out of production secured thereon royalties due the Government as in said leases prescribed and shall pay to said Oldland Group a royalty of 7½% of the market value at the time produced of the oil produced and saved on said lease embracing one-quarter of the permit area in which a Government royalty of 5% is prescribed and shall pay to said Oldland Group a royalty of 4% of the market value of the oil produced and saved on said lease embracing three-quarters of the permit area in which a graduated Government royalty is prescribed" (R. 15).

There are additional royalty provisions effective as to production of gas and casinghead gasoline. The agreement is specifically made binding upon assigns of the parties (R. 16).

The execution of the agreement itself did not end the efforts and activities of the Oldland Group in seeking to preserve the fruits of their hopes, visions and expenditures

over several previous decades. In addition to using the drilling equipment of the Oldland Group, McLaughlin used the active member and agent of said OLDLAND GROUP, one C. T. CARNEY, attorney in fact for said group, time after time to make recital under oath to the Secretary of the Interior of the hardships Carney and the other members of the group had undergone while placer claimants, in order to procure extension after extension of the drilling requirements of the permit. These applications for extension were accomplished through attorneys in Washington, D. C. employed by McLaughlin because of their expert knowledge in handling matters before the Secretary of the Interior.

The Land Office files (R. 394-442) reveal how repeatedly and eloquently McLaughlin and his attorneys relied in their applications upon the hardships, expenditures and equities of the pioneer placer claimants. Although employed by McLaughlin, these attorneys appeared in the Land Office as representing the Oldland Group and did not file with the Department of the Interior the assignment to him of the permit.

McLaughlin first appears in the Land Office files in a letter by him to the Secretary of the Interior dated March 11, 1935, asking for more time to drill and containing the statement:

> "I am and have been for some years past, holder of *operating rights* under the oil permit of Charles T. Carney, et al," (R. 438).

After the first appearance by McLaughlin in the land Office records, Carney continued to appear there for the original permittees. The permit was extended from time to time to December 31, 1937.

By his application for a lease of December 7, 1937, (R. 445), McLaughin for the first time designated himself as assignee of the permit. At this date change in the statute

had made a further extension of the permit unlikely. With his application he filed a photostatic copy of the assignment. When on December 23, 1937, the Secretary extended all valid permits to December 31, 1938, McLaughlin hastily withdrew his application for a lease (R. 446). The Denver Land Office was in April, 1938, directed by the Commissioner of the General Land Office to notify the parties interested in the permit that the "permit may not be extended beyond December 31, 1938, but the right to prospect the land may be continued under lease by the filing on or before that date of an application to exchange the permit for a lease under the provisions of the Act of August 21, 1935." (R. 447-448)

In November, 1938, McLaughlin applied for such lease (R. 448).

Under oath in his affidavit dated February 16, 1939, as to his qualifications to hold a lease, McLaughlin states:

> "That in the event of a lease being granted pursuant to his application of November 21, 1938, in exchange for Prospecting Permit Denver 033623, he is obligated to pay four per cent (4%)royalty to the Permittees specified in said Permit." (R. 451)

At this time C. T. Carney and several others of the original Oldland Group were dead and known by McLaughlin to be deceased (R. 288). Of course, the power of attorney under which Carney acted for the Oldland Group terminated at Carney's death.

Lease was issued to McLaughlin dated back to December 31, 1938, for a term of five years and as long thereafter as oil or gas was produced in paying quantities. It provides for a graduated royalty to the Government. (R. 458-470).

In November, 1939, in order to qualify himself to hold another government lease in the Rangely field, (R. 286) McLaughin quitclaimed one-half interest in this lease to his daughter, Evlyn Levison, and the other half interest to

Nellie Ione Gray, wife of H. W. Gray (R. 473-474). H. W. Gray originally negotiated for the Oldland group assignment and claims that he was the silent partner of McLaughlin in the permit from the beginning. (R. 342)

It is admitted there was no consideration for these quitclaims and that McLaughlin at the time expressly advised his grantees in writing of the Oldland Group's original assignment and subjected the interest quitclaimed to the 4% royalty provision of the assignment. (R. 518-519)

Phillips Petroleum Company commenced in late 1943 negotiations with Levison and Gray to acquire the lease (R. 267), but before any agreement was consummated between them, Phillips had learned of the Oldland Group's interest from examination of the Land Office files. The assignment to McLaughlin had also been of record in Rio Blanco County, where the land is situated, since 1932.

The state of mind of Phillips at the time is well expressed in the letter of its agent, Robert P. Reid, to H. W. Gray, who was representing his wife and Mrs. Levison, on March 10, 1944, as follows:

> "I am terribly afraid that there in an outstanding royalty of 4% on oil produced and 7½% on gas, reserved unto the original permittees. The General Land Office makes a practice of only supplying those instruments that affect the chain of title. Therefore, since there is no instrument in the file showing where the Oldland Group assigned all their right, title and interest to Mr. McLaughlin, I am afraid such reservation is now outstanding." (R. 591)

To this H. W. Gray replied on March 13, 1944:

> "I would suggest that Mr. McLaughlin give you any information regarding this reservation. As to an abstract of title from the County records, you will recall I forwarded you copy stating that there was

nothing of record in Rio Blanco County pertaining to the Permit. It looks to me that if this interest is still outstanding, that readjustment will have to be made because of the new royalty rates, but I am sure Mr. McLaughlin will be able to furnish you any further information that he has." (R. 592)

Reid, Phillips agent, on June 23, 1944, wrote to H. W. Gray:

> "However, it is now known that there is a reservation of 4% on oil and 7½% on gas to the original permittees, those being the Oldland Group. Consequently, to put this lease in line for an immediate conclusion, it is advisable that you have Mr. McLaughlin settle in some way the outstanding interest. Thus we should like to be supplied with satisfactory evidence as immediately as possible that such outstanding interest has been eliminated." (R. 593)

Gray, on June 26, 1944, replied to Reid:

> "Mr. McLaughlin is in Rangely and we will get in touch with him to see Ernest Oldland who I understand represents 50% or better, of the outstanding interests—the other people are scattered all over the country and are owners of very small interests individually, and I understand that they are all deceased." (R. 595)

McLaughlin talked to Ernest Oldland, but his conversation was limited to asking Mr. Oldland what interests he had in the Rangely field (R. 291). McLaughlin insisted that any warranty be stricken out of the assignment by Levison and Gray to Phillips. (R. 289).

Phillips did all of the necessary work in the Land Office to procure a renewal or exchange lease to Levison and Gray. (R. 477-478). The lease was issued dated back to January 1, 1944, and on May 22, 1945, was assigned by Levison

and Gray to Phillips with a reservation to the assignors of an overriding royalty graduated from 2-½% to 4-1/3%. Production was obtained on the land by Phillips in 1946 and this suit was instituted when on demand of Respondents the royalty rights of the Oldland Group were denied.

The conflict between Levison and Gray on their cross-claims against Phillips, and Phillips' cross-claims against them over the construction of their agreement and lease assignment was set for seperate trial by the district court and has not as yet been heard. This conflict arises from the contention of Phillips that the Oldland Group royalty is first a charge against the royalty of Levison and Gray (R. 68-42), which contention is met with the claim of Levison and Gray that such construction would in effect deprive them of the consideration for their assignment and entitle them to a reassignment of the lease (R. 43-46). In this connection they offer on reassignment to them to reimburse Phillips for all development expenses on the property (R. 100-104).

The Hon. J. Foster Symes, trial judge in the District Court, first rendered a memorandum opinion (R. 128-143) finding for the Respondents but allowing them not the royalty reserved in their assignment to McLaughlin but only the royalty reserved by Levison and Gray in their assignment to Phillips. After extensive argument on findings of fact and conclusions of law, the trial judge revised his opinion and entered judgment against Respondents (R. 205-206).

From this judgment appeal was taken to the Tenth Circuit Court of Appeals resulting in judgment of reversal and remanding the cause of or proceedings in conformity with the opinion (R. 611-621).

When Petitioners herein petitioned for a rehearing in the Court of Appeals, they interpreted the opinion and judgment of that court as do Respondents, that is as allow-

ing to Respondents a royalty of 4% of all oil produced from the land in controversy (R. 630). In their present Petition they attempt to construe the same opinion as allowing to Respondents a graduated royalty of from 3.32% to 3.5% of the oil produced.

SUMMARY OF ARGUMENT.

The claim of Respondents rests upon the assignment of the oil prospecting permit to McLaughlin in 1926 wherein it was provided that the Oldland Group of pioneers in the present Rangely oil field should receive a royalty of 4% on oil produced from three-fourths of the acreage on which a government lease on a graduated royalty should issue and a royalty of 7½% on the one-fourth of the acreage to be designated by McLaughlin on which the government royalty should be 5%. McLaughlin did not develop the permit nor did he terminate his obligations by reassignment as provided in the assignment. Instead, with the help of the Oldland Group, he procured extensions of the permit until by statute he was required either to develop the land and procure lease as provided under the 1920 Act or exchange the permit for a five year lease on a graduated government royalty for all the acreage. He chose the latter course, and in November, 1938, applied for exchange lease. He then filed his affidavit in support of his rights as assignee of the permit stating:

> "That in the event of a lease being issued pursuant to his application of November 21, 1938, in exchange for prospecting permit Denver 033623 he is obligated to pay four per cent (4%) royalty to the Permittees specified in said Permit" (R. 451).

It is the contention of Respondents that under the terms of the assignment to McLaughlin they were the owners of a royalty interest in oil which thereafter might be produced by McLaughlin or his assigns from the land covered by the prospecting permit and under any lease arising from said

permit. Whether this royalty interest of the Oldland Group be called legal or equitable is of no great consequence. It was a vested right and of record in Rio Blanco County in 1932 and in the General Land Office in 1938.

No contention was made below or is made here by Petitioners that the quitclaims of the lease by McLaughlin to Levison and Gray cut off any rights of the Oldland Group. Admittedly they were without consideration and with written notice to the grantees by McLaughlin quoting the royalty provision of the Oldland Group assignment and specifically subjecting the quitclaimed lease to it. (R. 518-519)

Admittedly also Phillips acquired its lease from Levison and Gray with actual knowledge of the Oldland Group's royalty. Whatever the rights may be between Levison and Gray on one hand and Phillips on the other on their cross-complaints, Respondents have no concern with them. We contend that the rights of the Oldland Group have been in no way adversely affected by the two lease transfers under the circumstances shown by the undisputed evidence. Before the law Phillips can stand in no better position than would McLaughlin had he developed the property and continued to hold the lease.

The principal contention raised on this Petition for Certiorari is one not raised in the same form below until petition for rehearing in the Court of Appeals to the effect that recognition of the Oldland Group royalty constitutes deprivation of property without due process of law contrary to the Fifth Amendment. We find no authorities in point cited by Petitioners to sustain such contention.

It would rather appear to be more appropriate for Respondents to be here complaining of their 7½% reserved royalty on one-fourth of the acreage being cut to 4%. However, the Rector Group of Respondents, who file this brief, have in the courts below consistently taken the position that the interpretation placed upon the assignment after the Act

of 1935 by the Petitioners themselves of a 4% royalty on all the acreage was agreeable to them. The argument of Petitioners that these interpretations on their part made by affidavit or otherwise to the government or among themselves and unknown to the Oldland Group were merely offers which failed for want of acceptance by the Oldland Group is too absurd for extended comment. Certainly McLaughlin's affidavit would in itself constitute a declaration of trust. Through the entire evidence can be discerned the hope and belief of McLaughlin, later joined in by Levison, Gray and Phillips that perhaps the Oldland Group would all die off and their heirs and successors never know that the Pioneers had truly found a great oil field and had not suffered and worked in vain.

It may be noted that Petitioners have consistently to the time of filing petition for rehearing in the Court of Appeals contended against the allowance to Respondents of a 7½% royalty on one-fourth of the acreage on the ground that the court could not conjecture as to which one-fourth it should be. Now they very readily identify it, as it no doubt would have been chosen, as the one-fourth first developed and closest to the center of the oil field. They then cite production figures from this "conjectural" one-fourth to attempt to add concreteness to an insubstantial argument.

I.

THE PETITION FOR WRIT OF CERTIORARI AND BRIEF OF PETITIONERS MISINTERPRET THE DECISION OF THE CIRCUIT COURT OF APPEALS.

In the Petition and Brief in support thereof it is contended that the decision of the Court of Appeals does not grant to Respondents a royalty of 4% of all oil produced but that it is a sliding royalty of 3.32% to 3.5% depending upon production and the amount of royalty payable to the government. This interpretation is here made for the first

time by Petitioners who in the Court of Appeals in their petition for rehearing (R. 630-631) interpreted the decision as granting Respondents a full 4% of oil produced.

The portion of the opinion below on which this new interpretation is based is quoted at Page 7 of the Petition as

> " • • • the appellants are entitled to an overriding royalty of 4 per cent of the oil and 7½ per cent of the gas produced, saved and sold from the leasehold estate, free and clear of cost, subject only to the Government royalty."

This partial quotation may, if taken alone, be ambigious. Certainly all oil produced under the government lease is subject to the government royalty. It is clear from the following quotation of the entire paragraph from which the above quotation was taken that Petitioners' interpretation is not correct.

> "When McLaughlin applied for his exchange lease under the 1935 Amendment, he acknowledged his obligation to pay the original permittee 4 per cent on all oil produced under the lease. When in 1944 Phillips was negotiating for the acquisition of the lease, a Company representative expressed the view that there was an outstanding royalty of 4 per cent of the oil and 7½ per cent of the gas 'reserved to the original permittees.' Giving full force and effect, therefore, to the provisions of the 1935 and 1942 Amendments providing for a minimum Government royalty of 12½ per cent, as well as the understanding of the parties, especially the appellees, we hold that a trust relationship was created binding upon all parties in the chain of title; that such relationship was not extinguished by the 1935 or 1942 Amendments, and that in equity and good conscience, the appellants are entitled to an overriding

> royalty of 4 per cent of the oil and 7½ per cent of the gas produced, saved and sold from the leasehold estate, free and clear of cost, subject only to the Government royalty." (R. 621)

We do not wish to burden this brief with quotations from other portions of the opinion from which it is clear that the Court of Appeals found Respondents entitled to a royalty of 4% of all oil produced under the lease.

It is strange indeed that on their petition for rehearing in the court from which the opinion issued Petitioners should have construed it as do Respondents and in this Court construe it otherwise. Had their present interpretation of the opinion been raised upon the petition for rehearing, a clarification, if one is needed, might have been anticipated from the Court of Appeals.

II.

THE DECISION OF THE COURT OF APPEALS AS TO RESPONDENTS' ROYALTY AS TO THREE-FOURTHS OF THE ACREAGE IS IN STRICT CONFORMITY WITH THE PROVISIONS OF THE ASSIGNMENT WHEREIN IT IS RESERVED.

Petitioners would lead this court to believe that the decision of the Court of Appeals violates the Fifth Amendment in that the rights of the Oldland Group therein decreed were created only by the imagination or ingenuity of that court and founded upon neither contract nor property right.

The present government lease on the land in question provides for a graduated royalty to the government. (R. 485)

The assignment from the Oldland Group to McLaughlin provides that he "shall pay to said Oldland Group a royalty of 4% of the market value of the oil produced and saved on said lease embracing three-quarters of the permit area in which a graduated Government royalty is prescribed" (R. 15).

It therefore is clear that as to three-fourths of the land in controversy Petitioners cannot contend there has been any rewriting of a contract by the court below. We emphasize this matter in order that this court may not apprehend from Petitioners' Brief that their argument upon this point of the Fifth Amendment extends to the entire acreage of the present lease. It relates only to one-fourth of the area involved.

III.

THE DECISION OF THE COURT OF APPEALS AS TO RESPONDENTS' ROYALTY IN ONE-FOURTH OF THE ACREAGE AND LIMITING IT TO 4% IS A REASONABLE AND EQUITABLE FINDING CONFORMING TO THE CONSTRUCTION PLACED UPON THE ASSIGNMENT BY PETITIONERS THEMSELVES.

At the time the permit was issued and until its expiration December 31, 1938, the permittee was entitled by the Act of 1920 if he developed the land for oil to designate one-fourth of the permit acreage for lease at a 5% royalty to the government. The balance of the acreage was to be upon a graduated government royalty.

Admittedly by failing to secure leases in this manner under the permit McLaughlin and the Oldland Group lost the right to such 5% royalty lease on one-fourth of the land. The Act of 1935 providing for issuance of no further prospecting permits and providing for prospecting of government land only upon leases with graduated royalty eliminated this contingency. There is nothing in the Act of 1935 to indicate a public policy to destroy the rights of the Oldland Group under their private agreement with McLaughlin.

The problem then becomes to determine whether this change of the statute renders part of the agreement impossible of enforcement or understanding in law or equity.

The agreement itself provides for a royalty of 7½% of

oil produced on "said lease embracing one-quarter of the permit area in which a Government royalty of 5% is prescribed" and a royalty of 4% of the oil produced on the balance under a graduated royalty to the Government. (R. 15) This provision was such that it was to the interest of McLaughlin if he qualified for such leases to designate the most productive quarter of the land for the 5% lease as the total 12½% royalty to the Government and the Oldland Group thereon would have been less than the total royalty payable upon the balance under graduated lease. While this circumstance might enable a court to determine even at this time as do Petitioners in their Petition and Brief the one-fourth on which a 5% lease would have issued, the court below has not seen fit to allow a 7½% royalty to the Oldland Group on any of the acreage. It has instead interpreted Respondents' royalty to be 4% upon the entire acreage which is all subject to a graduated government lease.

The Court of Appeals in so concluding relies not solely upon the agreement itself but points out that its conclusion is identical with the construction placed upon the agreement after the Act of 1935 by Respondents. (R. 621)

McLaughlin's affidavit filed with the Secretary of the Interior in 1939 to procure lease in lieu of the permit states that "he is obligated to pay four per cent (4%) royalty to the Permittees specified in said Permit". (R. 451) The same conclusion was reached by Phillips before it took the lease as indicated by its letter of June 23, 1944, stating: "However, it is now known that there is a reservation of 4% on oil and 7½% on gas to the original permittees, those being the Oldland Group." (R. 593)

It is obvious that if the contract was rewritten, it was rewritten not by the Court of Appeals but by Petitioners themselves, and that if anyone suffered deprivation of property by the rewriting, it was the Oldland Group whose royalty was cut from 7½% to 4% on one-fourth of the acreage.

Using the production figures from Page 7 of the Petition, this loss of royalty to Respondents is $96.25 per day. However, the Rector Group of Respondents, who file this brief, have in the courts below requested Findings of Fact and Conclusions of Law (R. 192) similar to those found by the Court of Appeals, in order to remove this question from the case, and do not now complain of this reduction of the royalty provided in the assignment.

IV.

THERE HAVE BEEN NO FUNDAMENTAL CHANGES IN THE NATURE OF RIGHTS GRANTED BY THE UNITED STATES TO EXPLORE AND DEVELOP ITS LANDS FOR OIL AND GAS SINCE THE ACT OF 1920.

We state briefly below the history of the Leasing Act of 1920 in order to show that no fundamental change has been made as to the rights granted private persons by the Federal Government.

Sections 13, 14 and 15 (41 Stat. 441) of the original Act provided authority to the Secretary of the Interior to grant prospecting permits for a period not exceeding two years on lands of the United States not within any known geological structure of a producing oil or gas field. The permits to be on condition that the permittee within six months shall drill a well to a depth of at least 500 feet and within two years from date of permit to a depth of 2000 feet.

It further provided that the Secretary of the Interior, if he found the permittee unable with diligence to test the land in the time granted, might extend the permit for not exceeding two years; that upon establishing to the satisfaction of the Secretary that valuable deposits of oil or gas had been discovered, the permittee was entitled to a lease on one-fourth of the land for a period of twenty years at a royalty of 5% of the oil produced and a preference right to a lease

for the remainder of the land at a royalty of not less than 12½%; that prior to application for a lease the royalty should be 20% to the United States on oil produced under the permit.

The Act of January 11, 1922 (42 Stat. 356) authorized extension of time for drilling not to exceed three years.

The Act of April 5, 1926 (44 Stat. 236) authorized a further extension of two years.

The Act of March 9, 1928 (45 Stat. 252) authorized extension for two years.

The Act of January 23, 1930 (46 Stat. 56) authorized extension for three years.

The Act of June 30, 1932 (47 Stat. 445) authorized extension for an additional three years.

The Act of August 21, 1935 (49 Stat. 674) extended all permits to December 31, 1937, with authority to the Secretary to extend for one additional year but not beyond December 31, 1938.

The Act of August 26, 1937 (50 Stat. 842) provided that in certain cases where pooling agreements had been approved or drilling prosecuted the permits were extended to December 31, 1939.

The term of the leases to be issued to permittees under the 1920 Act was twenty years with the right of renewal for successive periods of ten years. (Secs. 14 and 17)

The 1935 Act provided that lands not within any known geological structure of a producing oil or gas field might be leased at a royalty not less than 12½% and for a period of five years and as long thereafter as oil is produced in paying quantities. Preference right to such lease was given to permittees to receive such lease.

The 1942 amendment provided for preference right to a lessee for issuance of a renewal lease.

From these statutes and amendments it is clear that there has been since 1920 no fundamental change in the nature of rights granted by the United States for the exploration and development by private persons of lands believed to contain oil or gas, and that the policy has consistently been to extend and renew the rights of persons who had acquired such rights.

Judicial discussion of the nature of these rights indicates no fundamental distinction other than in nomenclature between a "prospecting permit" and a "lease".

In Herigstad vs. Hardrock Oil Co., 52 P. 2d 171, 173; 101 Mont. 22, the Court said:

> "The 'prospecting permits' issued under authority of the Act of Congress (Feb. 25, 1920, Chapt. 85, Sec. 13, 41 Stat. 441, 30 USCA Sec. 221) constitute more than a license to the permittee, and, if exclusive possession for a definite period creates an interest in land, they have this effect, for such a permit grants, in writing, 'the exclusive right, for a period not exceeding two years, to prospect for oil or gas' upon a selected tract not exceeding 2560 acres, which time may be extended under certain conditions. (Sec. 224, 30 USCA P. 402) Discovery of oil or gas entitles the permittee to a lease on one-fourth of the land included in the permit upon a royalty of 5 per cent in amount of the value of production and to a preference right to a lease on the balance of the land on a 12½ per cent royalty. Section 223, 30 USCA P. 401. After production of oil or gas, the permittee is entitled to that produced, until application for the lease, on payment of 20 per cent of the gross value to the government. Sec. 244 30 USCA."
>
> "Under the Act and the authorities, the government 'prospecting permit' would seem to be practically equivalent to the ordinary lease of privately owned

land thought to contain oil and gas; the government merely adopts a different method of handling the matter."

"This 'grant of a valuable right' does not differ from the grant contained in the ordinary oil and gas lease executed by the individual owner, and whatever the rule may be in other states, in this jurisdiction such a right is held to take 'the character of an interest or an estate in the land itself. It is an estate in the land although incorporeal'."

The same court in Aronow v. Bishop, 86 P. 2d 644; 107 Mont. 317, in subjecting the later lease to royalties arising by assignment by a former permittee said:

"The permit is not extinguished by the granting of leases. It is the foundation for leases and when granted to the permittee or his assignee, they merely constitute in substance and effect, a continuation of rights granted by the permit but under different terms and conditions. Sec. 223, Title 30 USCA."

Petitioners' arguments based upon the claim that the 1935 Act and 1942 Act in some manner created a new type of lease which is of an entirely different order and character from the previous lease and prospecting permit are based upon hypertechnical interpretations inconceivable in a court of equity.

V.

PETITIONER PHILLIPS PETROLEUM COMPANY ACQUIRED AND DEVELOPED THIS PROPERTY WITH ACTUAL KNOWLEDGE OF THE ROYALTY INTERESTS OF RESPONDENTS.

We have quoted in our Statement of the case and elsewhere in this brief the letters of Phillips to H. W. Gray, agent of Levison and Gray, showing that Phillips was from the Land Office Records fully familiar with the entire history

of the permit, the assignment, McLaughlin's affidavit, and the lease issued in lieu of the permit. Phillips while negotiating with Levison and Gray aided in their obtaining the present lease in exchange for the lease issued to McLaughlin.

In view of this fact one can only conjecture as to the bearing this may have had on the final agreement between Phillips, as buyer, and Levison and Gray, as sellers, of the property. That Phillips knowingly assumed the risk that the Oldland Group would assert its claims to the royalty is clear.

Under such circumstances no amount of expenditure by Phillips could improve its equitable or legal position relative to the Oldland Group.

The two last cited cases of Herigstad v. Hardrock Oil Co., 52 P. 2d 171; 101 Mont. 22, and Aronow v. Bishop, 86 P. 2d 644; 107 Mont. 317, both resulted in holding the subsequent lessees liable for and subject to the royalties arising out of the permit since they had knowledge thereof. We do not burden this brief with quotations upon this well established rule.

That the venture was a successful one of great profit to Phillips is shown by its own production figures. It has not accepted the offer of Levison and Gray made by way of cross-claim (R. 104) asking reassignment of the lease to them in return for reimbursement by them to Phillips of all of its expenses of securing and improving the lease.

VI.

LIMITATION BY REGULATION OF OVERRIDING ROYALTIES TO 5% IF APPLICABLE OR VALID WOULD DESTROY THE LEVISON AND GRAY ROYALTY RESERVED IN 1945 RATHER THAN THE PRE-EXISTING OLDLAND GROUP ROYALTY RESERVED IN 1926.

Although the Court of Appeals determined the Oldland Group to be limited to a royalty of 4% of oil on all of the

acreage, Petitioners again cite in this Court a federal administrative regulation limiting overriding royalties to 5%. They contend that the Oldland Royalty added to the Levison and Gray royalty exceeds 5% as to the oil. They contend also that the 7½% royalty on gas decreed to the Oldland Group is in excess of that allowed by the administrative officials.

In answer to this argument we point out that the regulation in question was adopted long after the assignment by the Oldland Group to McLaughlin; that the Levison and Gray royalty is in dispute between them and Phillips upon their cross-claims yet to be tried in the District Court, and there Phillips has pleaded that if the Oldland royalty is established, Levison and Gray should receive none; that the Levison and Gray royalty reserved in 1945 would as junior in time and in right be first destroyed if the regulation is applicable or valid.

Finally we point out a few of the authorities for the rule that the Federal Courts will in decreeing the rights of parties not anticipate the action of administrative officials of the government, nor will the administrative officials assume the judicial role of determining the rights of private parties between themselves.

In Isaacs v. DeHon, 11 F. 2d 943, in an action upon a grubstake agreement for an interest in a government prospecting permit, the defense included alienage, failure to join the Secretary as a party and regulations regarding assignment. The Court found none of these a defense in a court of equity, saying:

> "If the Plaintiffs are aliens, appellant is in no position to take advantage of this circumstance. No one but the Sovereign has any right to complain of a trust in real estate in favor of an alien disqualified to hold title. Osterman v. Baldwin, 6 Wall. 116. * * * Such a

trust is valid until, at the instance of the government, the alienage is judicially established.

"Appellant is in no position to take advantage of this regulation. It may be that the Plaintiffs will lose the fruits of this litigation by the refusal of the Secretary to approve the assignment of interests in the permit. But appellant is nevertheless held in a court of equity to the obligations he has assumed in this grubstake contract."

"The courts will not interfere by mandate or injunction with his performance of his duties under the public land laws. * * * But the courts do have power to enforce contracts with reference to lands while title thereto is held by the government. Marquez v. Frisbie, 101 U. S. 473; Pappe v. Trout, 41 P. 397, 3 Okla. 260."

The regulation on transfers was again unsuccessfully raised in Witbeck v. Hardeman, 51 F. 2d 450, affirmed 52 Sup. Ct. 604, 286 U. S. 444, where the Court said:

"This restriction on transfer applies to voluntary transfers and will hardly be deemed applicable in case of death, bankruptcy or court decree. But the difficulty is met by the just assumption that the Secretary intends that leases and permits shall go to those whom the law entitles to them, and when a transfer is ordered to accomplish this his consent is to be implied, and may be compelled, if refused."

The ordinary procedure of the Department of the Interior when conflicting claims arise is to suspend action until the parties can litigate their rights between themselves in a court of competent jurisdiction, as is shown in the recent case of Blackner v. McDermott, 176 F. 2d 498, 500.

VII.

THE DECISION OF THE COURT OF APPEALS CONFORMS TO THE SETTLED RULES OF LAW AND EQUITY OF THE SUPREME COURT OF THE STATE OF COLORADO AND OF THE FEDERAL JUDICIARY.

While in the Petition herein it alleged that the decision of the Court of Appeals is contrary to the law of Colorado, we find no authority to that effect in the Brief in support thereof. This brief would become unduly long if we were to cite the Colorado authorities on the principles that a trust will not be divested by a conversion of the trust property by the trustee, that equity looks to the substance and not to the form, that a purchaser with knowledge takes subject to all equities and other general principles applicable to this case. Colorado has had little litigation over oil and gas property and we must go elsewhere for cases involving similar factual situations. That overriding royalties are interests in real estate in Colorado has been established by Pierce v. Marland Oil Co., 278 P. 804, 86 Colo. 59.

Where similar facts have existed we submit that there has been no authority other than supporting the decision of the Court of Appeals in this case.

In the same court was considered the case of Merritt Oil Corporation v. Young, 43 F. 2d 27, arising from a contract relative to oil placer claims made in 1915. After the 1920 Act became effective the claims could not be patented by the assignee as contemplated but by compromise with the government 800 acres were patented, 80 acres covered by a government lease and 1880 acres by prospecting permit. To an action to recover against the later holder an interest in the lease and permit the defense was asserted, as here, that a different kind of property than that contemplated by the contract had come into being and that the contract could not be enforced as to it. The Court answered this:

"A mere statement of the contention answers it. No interest is more zealously guarded by courts of equity than that of a cestui que trust. To permit a trustee to oust his cestui because the title to the trust estate fails in part, and to thus enrich himself, is unthinkable. This court has spoken, in no uncertain terms, on this subject, in Skinner v. Cromwell, 40 F. (2d) 241, 244. There an oil and gas lease held in trust, was conceived to be void and was canceled. A new lease, on the same property, was taken by the trustees in their own name, and approved by the Secretary of the Interior. The trustees claimed to own it personally, contending that the lease held by them as trustees no longer existed. This court held that 'their trust relation was such they could not deal with the subject in their private interest without first reporting the facts to their cestuis que trustent and giving them an opportunity to take or waive whatever benefits might be gotten out of the situation.' The court quoted with approval from 1 Perry on Trusts (5th Ed.) Chap. 196, as follows: 'If among the assets of the trust estate there are leases, the trustee cannot renew them in his own name; and if he renews them in his own name, he must hold them by a constructive trust for the same persons beneficially interested in the old lease.'

"The record clearly shows, and counsel for appellant concedes, that the appellant acquired the title to these properties by a 'compromise agreement made by the appellant and the government'; that is, by a surrender of its rights under the locations made in 1915. Mr. Justice Story laid down the governing principle when he said in Oliver et al v. Piatt, 3 How. 333, 401, 11 L. Ed. 622, that:

'And if the trustee has invested the trust property, or its proceeds, in any other property into which it can

be distinctly traced, the cestui que trust has his election either to follow the same into the new investment, or to hold the trustee personally liable for the breach of the trust. * * * The option, in such case, to take the new or the original fund is therefore, (as has been already suggested,) exclusively given to the cestui que trust, and is given to him for the wisest purposes and upon the soundest public policy. It is to aid in the maintenance of right and in the suppression of meditated wrong' . . .

"Appellant further contends that it is unfair to carry the trust, originally intended for located claims, over to an oil and gas lease and prospecting permit, with their attendant burdens. Appellant was not compelled to accept the lease and permit; it could have stood on its locations, and won or lost. When it accepted part in compromise of its claim for all, the rights of the cestui are not thereby divested; on the contrary, the trust attaches to the property received through such compromise. This contention of appellant is unfounded."

The same court more recently in Blackner v. McDermott, 176 F. 2d 498, had a similar question as to whether an operating agreement as to one lease extended to a subsequent lease from the government. The contentions and opinion of the court are stated by it:

"It may be that as between the United States and Blackner the second lease was a new one rather than an extension or renewal of the former lease. But that is not the test here. The test to be applied here is whether as between McDermott and Blackner the second lease was an extension or renewal of the first, within the intent and meaning of the original operating agreement. And in resolving that question, the language contained in the operating agreement, the rela-

tionship existing between the parties, and the background against which the agreement was drafted and entered into must be taken into consideration. Viewed in that manner, it is crystal clear that it was the mutual intention of the parties in entering into such agreement that their rights should continue throughout any lease which should issue as the outgrowth of their joint efforts then being exerted in connection with the preparation and filing of the original application, and otherwise. When all of the facts and circumstances are taken into consideration and given the weight to which they are entitled, it would unduly narrow the scope of the contract to construe it as having application only to the original lease, either during its primary period or during an extended or renewed period of it, but not to a subsequent lease to the same lessee which was the outgrowth of the joint efforts of the parties at the time of the filing of the application for the original lease and at the time of the issuance of such lease."

Similar questions arose in Dougherty v. California Kettleman Oil Royalties, Inc., 69 P. 2d 155, 9 Cal. 2d 58, and its related case General Petroleum Corp. v. Dougherty, 117 F. 2d 529. In the former case, after extended litigation, it was held that Dougherty was entitled, upon the strength of Ochsner's oral agreement made at the time of applying for a prospecting permit with the aid of Dougherty's knowledge of geology and procedure, to recover royalties accruing to defendant corporations, assignees of Ochsner. The Court said P. 167:

"This is an action to enforce a trust as to oil royalties. Such an action is clearly enforceable against an assignee who takes with notice of the outstanding royalty. Western Oil Co. v. Venago Oil Corp., 218 Cal. 733, 24 P. 2d 971, 88 ALR 1271. Even if the covenant on the part of Ochsner were a more personal

covenant it would be enforceable in equity against those who took with notice . . . . In the Present case the trial court found that both Universal and appellant took their respective assignments with full knowledge of Dougherty's outstanding claim . . . . Another complete answer to this point (the plea of the Statute of Frauds) is that under the facts of this case the moment the permit was issued a trust resulted in favor of Dougherty. (citing cases)"

In the General Petroleum case impossibiilty of performance was pleaded to Dougherty's claim to the royalty allowed him on the ground that in the meantime the land in question had been pooled with other land. This was answered by the Court:

"This appellant itself made it impossible to develop oil under the Permit lands in the manner contemplated under the Ochsner contract, and the royalties from that source were cut off, and there was substituted therefor the royalties allotted to appellant by Kenda based on the permit area in which appellees are entitled to their proportionate share. Where a trustee in violation of his trust has changed the trust property or its proceeds into other property the cestui que trust has his option, either to hold the substituted property liable to the original trust, or to hold the trustee liable for breach of trust. (citing cases) This right or option of the cestui que trust belongs exclusively to him and it is not in the power of the trustee to deprive him of it."

The well reasoned decisions in these and similar cases illustrate that in circumstances varying more from the situation contemplated by the parties originally than in the instant case the equities will be followed by the courts through the web however complex.

It is elementary that in oil and gas leases and related

transactions the primary consideration is the royalty to accrue to the lessor or assignor.

At all times by the very terms of the assignment by the Oldland Group to McLaughlin he had the privilege of terminating his obligations by reassigning and paying the small sum provided in case he had not developed the property. It would be unconscionable if Petitioners should now by means of hyper technical argument and by calling upon the founding fathers through the Fifth Amendment succeed in depriving the original pioneer placer claimants and their successors of the fruits of their labors and vision.

CONCLUSION.

The Rector Group of Respondents pray that the Petition for Writ of Certiorari be denied.

Respectfully submitted,

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